

Dated: December 13, 2004
The following is ORDERED:





Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re
MERIDIAN CORPORATION,
a/k/a MEDSHARES, INC.,
Debtors.

Case Nos. 99-28923-L through 99-29025-L
Chapter 11

and

In re
SYMPHONY HOME CARE SERVICES
NO. 18 - LOUISIANA, INC.,
Debtor.

Case Nos. 99-30101-L through 99-30125-L
Chapter 11
JOINTLY ADMINISTERED

In re
MEDSHARES, INC.
OF CALIFORNIA,
Debtor.

Case No. 99-28981-L
Chapter 11

MEMORANDUM AND ORDER
ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

BEFORE THE COURT are the motion for summary judgment filed by the Debtor, Medshares, Inc. of California, and the cross motion for summary judgment filed by HCA Inc., f/k/a

HCA – The Healthcare Company, formerly Columbia/HCA Healthcare Corporation, and its affiliates (collectively, “HCA”). The motions relate to two underlying motions filed October 16, 2000, by HCA for allowance of the following administrative expense claims against the Debtor:

<u>Location</u>	<u>Amount</u>	<u>Property Address</u>
West Hills, Ca.	\$152,630.49	7320 Woodlake Ave., Suites 110 and 170, Woodlake Medical Center
Gilroy, Ca.	\$ 11,778.50 ¹	7855-D Wren Avenue
San Jose, Ca.	\$558,688.80	2025 Gateway Place, Suites 224 ,234, 260, and 270

National Century Financial Enterprises (“NCFE”), the holder of certain pre- and post-petition claims against the Debtor’s bankruptcy estate, has filed a response in support of the Debtor’s motion. Both the Debtor and HCA contend that there are no genuine issues of material fact remaining to be resolved, but each asserts that it is entitled to judgment as a matter of law. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B).

FACTS

The following facts are undisputed. On September 23, 1998, HCA and Medshares Consolidated, Inc. (“Medshares”) entered into an Asset Purchase Agreement (“APA”) providing for

¹ This figure was subsequently amended to \$15,416.00 in HCA’s memorandum of law to include a check for \$3,637.50 paid by an HCA affiliate to the Gilroy Landlord on behalf of the Debtor. However, since HCA has not amended the amount requested in the Administrative Expense Request, the only figure before the court on HCA’s motion for summary judgment is \$11,778.50.

the purchase and sale of certain home health agencies owned and operated by HCA, including, specifically, a home health agency known as the West Hills Home Health Agency at premises known as 7320 Woodlake Ave., Suites 110 and 170, Woodlake Medical Center, West Hills, California; a home health agency known as San Jose Healthcare System, L.P., at premises known as 7855-D Wren Avenue, Gilroy, California; and a home health agency known as San Jose Healthcare System, L.P., at premises known as 2025 Gateway Place, Suites 224, 234, 260, and 270, San Jose, California. (Collectively these home health agencies are known as the “California Home Health Agencies.”).

Pursuant to the APA, closing was to occur on or after October 15, 1998, and, with respect to leases, was to be accompanied by an assignment executed by HCA. The APA is silent as to the assumption of the leasehold obligations of HCA by the buyer. With respect to the California Home Health Agencies, the buyer was anticipated to be the Debtor.

On July 29, 1999, the Debtor and 102 affiliated companies filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in Memphis, Tennessee. On August 20, 1999, another 25 affiliated agencies filed voluntary petitions as well. On August 30, 1999, an order was entered providing for the joint administration of all the cases. On June 26, 2003, an order was entered approving the sale of substantially all the assets of the Medshares debtors to TBJG, LLC. Pursuant to the terms of sale, all administrative claimants share pro rata in a fund of \$1,250,000.00. The court is now in the process of liquidating the remaining administrative expense claims so that payments can be made pursuant to the terms of sale.

The proof of claim filed by HCA in this case indicates that Medshares gave notice prior to closing that it would be unable to pay the cash portion of the purchase price called for in the APA. It obtained HCA's consent to a 14-day deferral for the payment, but never made the payment. Further, Medshares defaulted on payment due HCA under a note given for the balance of the purchase price. HCA has allocated to the Debtor a portion of the amounts due by Medshares for each of these obligations. In addition, HCA claims that pursuant to the APA, Medshares and the Debtor assumed certain obligations which were not performed by the Debtor. HCA claims that its pre-petition claim against the Debtor as the result of failure to perform assumed obligations for the West Hills Home Health Agency is an amount not less than \$386,004.38; for the Gilroy Home Health Agency is an amount to be determined; and for the San Jose Home Health Agency is an amount not less than \$613,604.80. These obligations are identified in Exhibit A to HCA's proof of claim as "Lease on Real Property." Finally, HCA claims that it is owed an undetermined amount from the Debtor pursuant to a Collection Agreement entered into with Medshares and related debtors including the Debtor in this case.

In addition to its pre-petition claim, HCA has filed several motions for allowance of post-petition administrative expenses as listed above. The motion claims that the prior tenants, HCA-affiliated entities, paid rent on the Debtor's behalf and thus provided a benefit to the bankruptcy estate. Further, HCA claims that by paying the rent owed, it is subrogated to the rights of the landlords of the West Hills, Gilroy, and San Jose premises (collectively, the "Landlords"), including the right to pursue an administrative expense claim.

West Hills Lease

The lease for the West Hills Home Health Agency (the “West Hills Lease”) is dated June 5, 1997. The parties are Woodlake Properties, as landlord (the “West Hills Landlord”) and West Hills Hospital, Inc., doing business as Columbia West Hills Medical Center, an affiliate of HCA, as tenant (the “Prior HCA West Hills Tenant”). The West Hills Lease relates to property located at 7320 Woodlake Avenue, Suites 110 and 170, West Hills, California (the “West Hills Premises”).

The parties do not agree on the rent accrued under the West Hills Lease during the post-petition period. The Debtor asserts that the monthly rental was \$8,384.75 while HCA asserts that the monthly rental was \$13,321.40. The Debtor took possession of the West Hills Premises on September 23, 1998. The Debtor included the West Hills Lease among those that were rejected by order entered March 8, 2000, which specifies that rejection “shall be effective as of the date the Property was or is scheduled to be closed.” The attachment to the order indicates that the West Hills Premises was scheduled to be closed on January 15, 2000. The Debtors vacated Suite 110 on October 29, 2000. The Debtor claims it never occupied Suite 170. The Debtor asserts that it paid post-petition, pre-rejection rent to the West Hills Landlord for Suite 110 in the amount of \$126,359.72. The total amount due for post-petition occupancy of Suite 110 per the Debtor is \$145,463.63. According to HCA, the total amount due for post-petition occupancy is \$213,142.40. HCA claims that it paid \$183,451.91 on the Debtor’s behalf for rent and office expenses during the period from August 1999 through August 2000.

Gilroy Lease

The lease for the Gilroy Home Health Agency (the “Gilroy Lease”) is dated April 15, 1995. The parties are R.J. Dyer Real Property Investments, Inc., as landlord (the “Gilroy Landlord”) and Home Health Care, Inc. (Visiting Nurses Association), an affiliate of HCA (the “Prior HCA Gilroy Tenant”). The Gilroy Lease relates to property located at 7855-D Wren Avenue, Gilroy, California (the “Gilroy Premises”).

The parties agree that the monthly rent according to the lease was \$2,771.50. HCA asserts that there was also a common area maintenance (“CAM”) charge of \$866.00 per month due under the Lease, but the copy attached to the Ramsey Affidavit does not mention a charge for CAM; the Debtor does not recognize that a charge for CAM was due under the Gilroy Lease. The effective date of the order allowing rejection of the lease was February 29, 2000, at which time both parties agree the Debtor vacated the premises. The post-petition, pre-rejection occupancy period was from July 29, 1999, until February 29, 2000. HCA, in its administrative expense claim, alleges that it paid lease expenses on the Debtor’s behalf totaling \$11,778.50 for the period of October 1999 through February 2000. The Debtor admits that it paid nothing for its post-petition, pre-rejection occupancy and admits that it owes \$19,393.50 for post-petition, pre-rejection occupancy.

San Jose Lease

The lease for the San Jose Home Health Agency (the “San Jose Lease”) is dated May 1, 1988. The parties are Copperfield Investment & Development Company, as landlord (the “San Jose

Landlord”), and Visiting Nurse Association, Inc., an affiliate of HCA, as tenant (the “Prior HCA San Jose Tenant”). The San Jose Lease relates to property located at 2025 Gateway Place, San Jose, California (the “San Jose Premises”).

The parties disagree about the monthly rent obligation of the Debtor. The Debtor occupied the premises continuously until it was evicted on October 15, 2000 (per Debtor), or October 11, 2000 (per HCA). By order dated January 12, 2001, the Debtor rejected the San Jose Lease effective September 25, 2000. HCA alleges that the rent was \$43,403.80 per month plus electricity, HVAC, and late fees. HCA claims that it paid rent on the Debtor’s behalf for the period from September 1999 through July 2000, totaling \$490,445.18. In connection with this and related motions, the court directed the parties to prepare a chart setting forth their various factual contentions and claims (the “Location Payment History Chart”). The Debtor claims on the Location Payment History Chart that the total monthly rent due under the lease was \$18,047.20, and explains the large discrepancy by asserting a lack of privity with the San Jose Landlord on addendums increasing monthly rental payments during the post-petition period; however, in the Debtor’s response to HCA’s Interrogatory 9, the Debtor lists monthly rental payments made or attempted to be made post-petition in the amount of \$43,403.80 per month. The Debtor paid a total in post-petition rental payments of either \$81,451.00 or \$61,451.00, according to the Location Payment History Chart which lists both as the total amount paid, without explanation; the Debtor’s Response to HCA’s Interrogatory 9 included Appendix A, which indicates that \$86,807.60 was paid post-petition by the Debtor. The Debtor further alleges that when it attempted to make payments to the San Jose Landlord, its checks

were returned to it because the San Jose Landlord did not recognize the Debtor as a tenant. The Debtor claims that the total amount due for post-petition occupancy was \$261,884.40, of which it has already paid either \$61,451.00, \$81,451.00, or \$86,807.60. From the Debtor's Response to Interrogatories it appears most likely that the Debtor has paid \$86,807.60 for post-petition, pre-rejection occupancy.

ANALYSIS

A. Standards for Considering Motions for Summary Judgment

Federal Rule of Civil Procedure 56(c), as incorporated by Federal Rule of Bankruptcy Procedure 7056, governs motions for summary judgment in adversary proceedings in bankruptcy. Summary judgment is proper if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). When a court reviews a motion for summary judgment, "the evidence, all facts, and any inferences that may be drawn from the facts must be viewed in the light most favorable to the nonmoving party." *In re Morris*, 260 F.3d 654, 665 (6th Cir. 2001) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)). The non-moving party must present enough evidence to show that there is a genuine issue of material fact in order to prevail. *Klepper v. First Am. Bank*, 916 F.2d 337, 342 (6th Cir. 1990). "A mere scintilla of evidence is insufficient; 'there must be evidence on which the jury could reasonably find for the [non-movant].'" *In re Morris*,

260 F.3d 654, 665 (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986)). Summary judgment should be entered “against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Where both parties file motions for summary judgment, the standard for determining whether summary judgment is appropriate is not altered. “[T]he court must evaluate each party’s motion on its own merits, taking care in each instance to draw all reasonable inferences against the party whose motion is under consideration.” *Lansing Dairy, Inc. v. Espy*, 39 F.3d 1339, 1347 (6th Cir. 1994) (quoting *Taft Broadcasting Co. v. United States*, 929 F.2d 240, 248 (6th Cir. 1991)).

B. The Interplay of Sections 365(d)(3) and 503(b)(1)

Upon the filing of the bankruptcy case, the Debtor became a debtor in possession, and was empowered to either assume or reject any executory contract or unexpired lease. *See* 11 U.S.C. §§ 365(a) and 1107(a). Even if the pre-petition Debtor had assumed the West Hills, Gilroy, and San Jose leases (collectively, the “Leases”), the post-petition debtor in possession retained the right to reject the Leases. The debtor in possession did elect to reject the Leases, and its election became effective as approved by the court as referenced above. Pursuant to 11 U.S.C. § 365(g), the rejection of an unexpired lease by a debtor constitutes a breach of the lease immediately before the filing of the petition. Damages flowing from the rejection of a lease become a pre-petition claim against the

bankruptcy estate. *See* 11 U.S.C. § 502(g). Pursuant to Federal Rule of Bankruptcy Procedure 3002, a claim arising from the rejection of an unexpired lease may be filed within such time as the court directs. HCA filed its proof of claim on March 30, 2000, which includes a claim for an undetermined amount arising out of the California Leases. No objection has been raised with respect to the timeliness of this claim.

A debtor in possession is obligated to timely perform the obligations of the debtor under any unexpired lease of nonresidential real property during the administration of a Chapter 11 case until the lease is assumed or rejected. *See* 11 U.S.C. § 365(d)(3). In this case, the debtor in possession paid some amount of post-petition rent.

Section 503(b)(1)(A) provides for allowance of claims representing the “actual, necessary costs and expenses of preserving the estate.” The Debtor argues that, notwithstanding the plain language of § 365(d)(3), HCA must show a benefit to the estate before its claim for post-petition rent will be entitled to administrative priority.

The timely-performance requirement was added to § 365 in 1984. The Bankruptcy Code specifies no remedy for failure to timely perform. *See Cannery Row Co. v. Leisure Corp. (In re Leisure Corp.)*, 234 B.R. 916, 923 (B.A.P. 9th Cir. 1999). Nevertheless, the Court of Appeals for the Sixth Circuit has held that a debtor in possession or trustee is obligated to pay all obligations that come due under an unexpired lease prior to the assumption or rejection of the lease. *See Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000). Further, the Sixth Circuit indicates in a footnote that the debtor’s obligation should be

determined without regard to the principles governing administrative claims under § 503(b)(1); a landlord need not demonstrate a benefit to the estate in order to be entitled to be paid post-petition, pre-rejection rent. *Id.* at n.2.

The specific question answered by the court in *Koenig* was whether a debtor would be obligated to pay the full month's rent that came due prior to rejection, or only a pro rata share representing the period of the debtor's occupancy. The debtor in *Koenig* rejected its lease effective the second day of the month. Under the terms of its lease, monthly rent was due in advance on the first day of the month. The debtor argued that it was obligated to pay a pro rata share of the rent representing its two days' occupancy. The court rejected this argument and held that the debtor was obligated to pay the full month's rent. *Koenig*, 203 F.2d at 989.

The Debtor argues that *Koenig* does not apply in its case because it never assumed the Leases. The court is not persuaded that the failure of the Debtor to assume the Leases means that the Debtor had no obligation to pay rent for its occupancy of the premises. The Debtor apparently agrees because it paid rent in the post-petition period for at least the West Hills and San Jose Premises. *See* discussion of the obligations of an assignee of a real property lease under California law *infra* at Section D.

The court is persuaded that *Koenig* does apply to the present case, and that the Debtor is obligated to pay rent for the period of its post-petition, pre-rejection occupancy. The requirements of § 503(b)(1) are not applicable here, meaning that in order to be entitled to post-petition, pre-rejection rent, a landlord need not show a benefit to the estate. The court must determine the amount

of the obligation of the Debtor during that period. If the pre-petition Debtor had assumed the Leases, then clearly the terms of the Leases would control. The court now turns to a consideration of whether the Debtor did, in fact, assume the obligations under the Leases pursuant to the APA or related documents and, if not, the appropriate measure of its obligation to the Landlords for its occupation of the West Hills, Gilroy, and San Jose Premises (collectively, the “California Premises”).

**C. Did the Debtor Assume the Obligations
of HCA under the Prior Leases?**

In its memorandum, HCA asserts that the Debtor “unmistakably assumed” HCA’s obligations under the Leases. In its motion, HCA’s statement is more guarded, stating that pursuant to the APA, the Debtor “agreed to assume” the obligations related to the operation of the California Home Health Agencies, including the Leases, and that upon closing of the sale, the Debtor took possession of the California Premises. As evidence of the assumption by the Debtor of the obligations due under the Leases, HCA points to the APA and an Assignment of Contracts and Assumption of Liabilities, dated October 16, 1998, by and between the Prior HCA West Hills, Gilroy, and San Jose Tenants (collectively, the “Prior HCA California Tenants”) and the Debtor (the “Assignment and Assumption Agreement”). Pursuant to the Assignment and Assumption Agreement, the Debtor expressly assumed those obligations described in section 2.3 of the APA that arose subsequent to the date of the agreement. Section 2.3 of the APA provides:

2.3 Assumed Liabilities. As of the Closing Date, Buyer shall agree to pay, perform and discharge the Assumed Liabilities. As used in this Agreement, the term “Assumed Liabilities” shall mean the following liabilities of the Owners: (i) the obligations of the Owners arising on or subsequent to the Closing Date under the Contracts; (ii) obligations of the Owners as of the Closing Date in respect of sick leave, extended illness bank, accrued vacation and accrued paid time off (collectively “PTO”) of the Owners’ or their affiliates’ employees who are employed by the Buyer or its affiliates as of the Closing Date; and (iii) the accounts payable of the Owners related to the Agencies, but only to the extent (a) such accrued vacation and accrued paid time off and (b) such accounts payable are included in the determination of the Final Net Working Capital Statement.

If the Debtor assumed the Prior HCA California Tenants’ obligations under the real property leases, it must be because the leases are contracts, because they are neither a PTO obligation nor an account payable. “Contracts” is a defined term under the APA. It includes, without limitation, all commitments, contracts, leases, and agreements described on Schedule 4.7 to the APA. *See* APA ¶ 1.1(h). Schedule 4.7 does not make reference to the Leases, nor to any other real property lease. Real property leases are listed in Schedule 4.8, which is described in the APA as the schedule of leasehold property to be assigned to the buyer at closing. *See* APA ¶ 1.1(a). With respect to the assignment of contracts, the Assignment and Assumption Agreements provide:

1. Assignment of Contracts. Subject to all the terms of the Agreement, Assignor hereby assigns, transfers, conveys and delivers to Assignee and Assignee hereby assumes all right, title and interest of Assignor in and to the Contracts (as defined in the [APA]). Assignee shall not assume or become liable or otherwise obligated for any contracts, obligations, or agreements of Assignor whatsoever except for such Contracts. The assignment of contracts herein also constitutes a delegation of the duties of Assignor under such Contracts, and, except as provided in the [APA], Assignee agrees to

assume the performance of the obligations of Assignor under such contracts that arise subsequent to the date hereof.

As we have seen, “Contracts” for purposes of the APA does not expressly include real property leases. Further, pursuant to this paragraph, the Debtor “agrees to assume,” but does not in fact assume, the obligations under the contracts.

In addition to the Assignment and Assumption Agreements, Bills of Sale were executed at closing pursuant to the APA. Pursuant to the Bills of Sale, HCA assigned its interest in all assets defined in the APA to the Debtor. Among the assets assigned to the Debtor pursuant to the Bills of Sale were the Leases, but the Bills of Sale are silent with respect to the assumption of liabilities related to the Leases. HCA has pointed to no agreement by which the Debtor expressly assumed obligations under the Leases. Since there was no assumption of the Leases, any post-petition obligation of the Debtor arises under California law pertaining to obligations of an assignee who takes possession of leased premises under an assignment.

D. What are the Obligations of the Debtor to the Landlords under California Law?

The Debtor as occupying assignee has an obligation to pay rent measured by the terms of the Leases which were assigned. The common law of the state governs these obligations. In California, as in many states which have adopted traditional common law jurisprudence, the remedies for the assignor of a nonresidential lease when the assignee fails to perform under the assignment depends upon the assignee’s actions post-assignment. If the assignee does not expressly assume the lease

but does take possession of the premises under an assignment, the assignee is not bound by the contractual terms of the lease but is in privity of estate with the original lessor, and takes the estate of the lessee (assignor) subject to the covenants that run with the land during the period of the assignee's occupancy. *See generally* 49 Am. Jur. 2d, *Landlord and Tenant* §§ 1112, 1132 (2004). The common law distinctions described in American Jurisprudence, specifically the privity of contract/privity of estate distinction, have been adopted by the California Supreme Court. *See, e.g., Kelly v. Tri-Cities Broadcasting, Inc.*, 147 Cal. App. 3d 666, 677 (1983) (citing various California Supreme Court cases and analyzing the relevant law in California). The obligation to pay rent is one of the covenants running with the land. *See* 49 Am. Jur. 2d, *Landlord and Tenant* § 1112 (2004) (“the assignee of a lease takes the whole estate of the lessee subject to performance on his part of the covenants running with the land [I]f through the assignee's neglect . . . to perform them the lessee is obliged to pay rent, . . . the assignor may recover from the assignee the sums so paid”); *see, e.g., Ellingson v. Walsh, O'Connor & Barneson*, 15 Cal. 2d 673, 675-76 (Cal. 1940) (“[t]he lease has a dual character; it is a conveyance of an estate for years, and a contract between lessor and lessee. The result is that dual obligations arise, contractual obligations from the terms of the lease [privity of contract], and obligations under the law from the creation of the tenancy [privity of estate].”). Where an assignment is made by the tenant to a third party who does not assume the obligations of the tenant arising because of privity of contract, the entry and occupation of the third party is still considered to be under the lease. The third party successor to the original lessee is bound by the covenant to pay rent in the lease, which arises from privity of estate and which runs

with the land. *Id.* Upon taking possession of the California Premises, the Debtor entered into privity of estate with the Landlords and became obligated to pay rent measured by the Leases.

For the post-petition, pre-rejection period, even though the Debtor did not assume the Leases, it nevertheless is obligated to pay rent measured by the terms of the Leases. The court next considers whether the date of entry of the order approving the Debtor's rejection of the Leases or the effective date of rejection specified in that order should be used in determining the Debtor's post-petition, pre-rejection obligation to the Landlords.

E. Does Date of Entry of Order or Effective Date of Rejection Determine Debtor's Obligation ?

The orders approving the Debtor's rejection of the Leases were entered as follows:

<u>Premises</u>	<u>Date Order Entered</u>	<u>Effective Date of Order</u>	<u>Date Debtor Vacated</u>
West Hills	March 8, 2000	January 15, 2000	October 29, 2000
Gilroy	May 26, 2000	February 29, 2000	February 29, 2000
San Jose	October 16, 2000	Jan. 15/Sep. 25, 2000 ²	September 25, 2000

The March 8, 2000 order allowing the rejection of the West Hills Lease specifically provides that rejection "shall be effective as of the date the Property was or is scheduled to be closed." The May 26, 2000 order allowing the rejection of the Gilroy Lease provides that rejection is "effective

² The Debtor was evicted either October 15 or October 11, 2000.

as of the date the Property was or is going to be vacated . . . [per] Exhibit A.”³ The October 16, 2000 order allowing the rejection of the San Jose Lease provides that rejection is “effective as of the [effective date] shown in Exhibit A.”⁴ Neither the Landlords nor HCA objected to the entry of any of the above mentioned orders. HCA argues that “the enforcement of a retroactive rejection order in this case would eviscerate the statutory protection provided to non-residential real property lessors and would inflict harm upon HCA.” Location Payment History Chart, n. 3. In support of its policy-based argument, HCA cites several cases, including *Thinking Machines*, for the proposition that “a rejection is effective only upon court approval of the decision to reject the lease.” *Id.* (citing *In re Revco Drug Stores, Inc.*, 109 B.R. 264, 269 (Bankr. N.D. Ohio 1989) (holding that the rejection process was designed to “provide a degree of factual certainty in determining the actual date of rejection.”); and *In re Federated Department Stores, Inc.*, 131 B.R. 808, 815-16 (S.D. Ohio 1991) (holding that setting the “effective date of rejection earlier than the order approving would put the Lessor in an unfairly awkward position.”)). HCA failed to point out that in *Thinking Machines*, the First Circuit noted that, “we think it behooves us to make clear that nothing in our holding today precludes a bankruptcy court, in an appropriate § 365(a) case, from approving a trustee's rejection of a nonresidential lease retroactive to the motion filing date.” *In re Thinking Machines Corp.*, 67 F.3d 1021, 1028 (1st Cir. 1995) After further analysis, the First Circuit found

³ Exhibit A to the order names an effective closure date for the Gilroy Premises of February 29, 2000.

⁴ Exhibit A to the order names two effective dates for San Jose Premises, one on January 15, 2000, and one on September 25, 2000.

the entry of a retroactive order to be appropriate so long as it does not penalize a creditor and so long as it promotes the purposes of § 365(d)(3). *See id.* (citing *In re Jamesway Corp.*, 179 B.R. 33, 37 (Bankr. S.D.N.Y. 1995)); *see also In re CCI Wireless, LLC*, 297 B.R. 133, 140 (D. Colo. 2003) (“the bankruptcy court has authority under section 365(d)(3) to set the effective date of rejection at least as early as the filing date of the motion to reject.”). The appropriate time for HCA to raise an objection to an order’s retroactively effective date would have been immediately following the entry of the order; had such an objection been raised, the court would have considered the equities of the case for the Landlords and the Debtor. Absent timely objection, HCA is bound by the terms of the rejection orders, including the provision of effective dates of rejection that predate the entry of the orders. The court next turns to the question of whether a debtor is entitled to prorate rent for the month in which it vacates leased premises pursuant to the Bankruptcy Code.

F. Is the Debtor Entitled to Prorate Rent for Less than a Full Month’s Occupancy?

The Debtor vacated the California Premises as noted above. The Debtor argues that it is entitled to prorate the rent for the months during which it vacated the various premises. *Koenig* holds that a debtor must pay a full month’s rent in accordance with the terms of a lease that provides for payment of rent monthly in advance. We have seen that even though the Debtor did not assume the Leases, the Debtor’s obligation to pay rent is measured by the terms of the Leases. Rent for the period of time from the expiration of the Leases until Debtor vacated the premises should not be prorated based upon the monthly rent paid during the Leases. The Debtor is obligated to the

respective Landlords to pay sixteen months' rent for its post-petition use and occupancy of the West Hills Premises, seven months' rent for its post-petition use and occupancy of the Gilroy Premises, and fifteen months' rent for its post-petition use and occupancy of the San Jose Premises.

Having found that at least in some respects the Debtor owes the Landlords for obligations due under the Leases, the court now turns to decide whether HCA, as subrogee, is entitled to be reimbursed by the Debtor for any payments made on behalf of the Debtor.

G. Is HCA Entitled to Be Subrogated to the Rights of the Landlords?

HCA claims that it is entitled to be subrogated to the rights of the Landlords vis-à-vis the Debtor to the full extent of payments made by it to the respective Landlords. HCA paid \$152,630.49 to the West Hills Landlord, \$11,778.50 to the Gilroy Landlord, and \$558,688.80 to the San Jose Landlord during the period between the filing of the petition and the rejection of the Leases by the Debtor. *See* Affidavit of Thomas F. Ramsey, dated November 7, 2002. Section 509 of the Bankruptcy Code provides:

(a) Except as provided in subsection (b) or (c) of this section, *an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment.*

* * *

(c) The court shall *subordinate to the claim of a creditor* and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement or contribution, of an entity that is liable with the debtor on, or that has secured, such creditor's

claim, *until such creditor's claim is paid in full*, either through payments under this title or otherwise.

11 U.S.C. § 509 (emphasis added). Clearly, full payment of the debt is required by § 509 before a subrogee can receive any reimbursement for payments made, since a subrogee's claim must be subordinated until the creditor is fully paid. *See In re Southwest Equipment Rental, Inc.*, 193 B.R. 276, 283-84 (E.D. Tenn. 1996) ("subrogation requires payment of the full debt"); *McGrath v. Carnegie Trust Co.*, 116 N.E. 787, 788 (N.Y. 1917) ("the equity of subrogation does not arise until the whole debt has been discharged").

HCA also asserts a right to subrogation outside of the Bankruptcy Code under principles of equitable subrogation. The question of whether § 509 and equitable subrogation are complementary, identical, or mutually exclusive has divided the courts that have considered the question. *See Pandora Industries, Inc. v. Paramount Communications, Inc. (In re Wingspread)*, 145 B.R. 784, 787 (S.D.N.Y. 1992) (describing the split of authority on the issue, identifying pertinent bankruptcy cases on point). The court in *Southwest Equipment Rental* held that "equitable subrogation is separate and distinct from subrogation rights afforded by § 509." *In re Southwest Equipment Rental, Inc.*, 193 B.R. at 283. The *Southwest Equipment Rental* court went on to outline the requirements for equitable subrogation:

- (1) payment must have been made by subrogee to protect own interest;
- (2) subrogee must not have acted as a volunteer;
- (3) debt paid must be one for which subrogee was not primarily liable;
- (4) entire debt must have been paid;

(5) subrogation must not work any injustice to rights of others.

Id. (citing *In re Flick*, 75 B.R. 204 (Bankr. S.D. Cal. 1987)). The *Southwest Equipment Rental* court pointed out that both equitable subrogation and subrogation under § 509 require payment of the full claim by the subrogee. *In re Southwest Equipment Rental, Inc.*, 193 B.R. at 283-84.

Undoubtedly, HCA is entitled to be subrogated to the rights of the Landlords to the extent that it discharged the Debtor's obligations to the Landlords for post-petition rent. *See* 11 U.S.C. § 509(a). HCA was liable with the Debtor to the Landlords for the value of the Debtor's use of the property.

The Debtor also made certain post-petition rent payments, however. The Debtor need not reimburse HCA for rent payments the Debtor paid to the Landlords on its own behalf. At most, if indeed HCA fully discharged the obligations due the Landlords under the Leases, it is entitled to be paid the difference between the amount owed by the Debtor and the amount paid by the Debtor.

With respect to the West Hills Lease and the San Jose Lease, similar principles would be applicable. However, the court cannot determine the amount that the Debtor owed monthly pursuant to those leases based on information submitted.

With respect to the Gilroy Lease, the Debtor owed \$19,400.50 (\$2,771.50 x 7 months). The Debtor actually paid \$0.00, leaving a balance owed to the Gilroy Landlord of \$19,400.50. HCA alleges that it paid \$11,778.50 on the Debtor's behalf. Until HCA pays the full obligation owed to the Gilroy Landlord, it is not entitled to be subrogated to the rights of the Gilroy Landlord.

CONCLUSION

For the foregoing reasons, the Debtor's motion for summary judgment is **GRANTED** in part and **DENIED** in part; and HCA's motion for summary judgment is **GRANTED** in part and **DENIED** in part. As for the Gilroy Lease, HCA is allowed a claim for post-petition rent in the amount of \$11,778.50, but is subordinated to the claim of the Gilroy Landlord. As for the San Jose Lease and the West Hills Lease, the court will schedule an additional pre-trial scheduling conference to establish a procedure for liquidating the amount of HCA's post-petition claim. The Debtor did not assume any of the Leases, but under California law has an obligation to pay rent measured by the terms of the Leases since they were all assigned to the Debtor. This obligation is an "obligation under the lease" for purposes of 11 U.S.C. § 365(d)(3), and as such the Debtor is obligated to pay the Landlords for post-petition, pre-rejection rent due under the Leases; such rent is not subject to proration based upon the occupancy period if an obligation came due prior to the effective date of rejection. This court has the authority to enter a retroactively effective order for the rejection of a lease. The obligation to pay rent during the post-petition, pre-rejection period is not an administrative expense, but is to be paid on a par with administrative expenses. Pursuant to both 11 U.S.C. § 509 and principles of equitable subrogation, HCA is subrogated to the rights of the Landlords to the extent that it discharged the Debtor's obligations to the Landlords for post-petition, pre-rejection rent, but HCA's claims are subordinated to the Landlords' claims until the Landlords are paid in full.